AN ANALYSIS OF THE MARKETING AND INVESTMENT STRATEGY OF THE NORTH AMERICAN AUTO INDUSTRY

DRAFT REPORT

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FOREWORD

This study addresses certain important aspects of the "automobile issue". It was not intended to examine in depth all the dimensions of this problem. The wide range of longer-run policy options available to the Canadian government is not examined in detail. Rather, this report explores the effects of the recently imposed limitations on Japanese automobile imports to the Canadian market given the existing, Canada-US Automotive Agreement, Canadian customs tariffs, etc...

The study focuses on, and derives the implications for Canadian policy of the marketing and associated investment strategies used in North America and elsewhere by the North American automobile producers. The author argues that the international marketing and investment strategies of these firms will, to a great extent, determine the impact, on the Canadian automotive manufacturing industries, of the restrictions on Japanese automobile exports to the North American market. The analysis has implications relating mainly to the probable impact of this measure on Canadian production and employment in automotive industry. However, Winham does point out that these import restrictions are necessarily contrary to the interests of Canadian consumers. He notes an absence of empirical studies to estimate the size of the loss to Canadian consumers.

On the basis of his examination of the impact of the limitations on Japanese automotive exports from the points of view of the immediate Canadian economic interests involved, i.e. (i) Canadians employed in the automobile industry and (ii) Canadian consumers, the author concludes that these measures are counter-productive. This result would presumably be reinforced by an examination of the broader potentially serious adverse implications of these measures for international trade relations generally and Canadian export development in particular.

Consumers' choice among alternative makes and models depends upon a large number of factors including energy efficiency, workmanship, reliability, comfort and price. Winham hypothesizes that recently increased consumer purchases of imported automobiles (at the expense of North American producers) reflect primarily a shift towards less expensive, fuel efficient and thus smaller automobiles in response to rapidly rising fuel prices. Frequent factory recalls by North American producers and the improved quality of some imports may also have contributed to this shift to imported automobiles. One might expect that North American producers would respond to competition from high quality imported automobiles by improving the quality of their own product. This consideration reinforces the author's contention that the restrictions on Japanese exports of automobiles to the Canadian market should be removed at the earliest possible date.

CONTENTS

		Page
I	Executive Summary	1
II	Background	
	1. Policy issues	2
	2. History of the Industry	4
III	Analysis	
	1. Downsizing	6
	2. Overseas Investment	14
IV	Policy Conclusions	24
	Footnotes	27
	Bibliography	31

I EXECUTIVE SUMMARY

The auto industry has been pressing the Canadian Government, for some time, to impose import restrictions on Japanese automobiles. Japan has recently agreed to voluntarily restrain exports to Canada for one year, but this will only afford temporary relief in a much longer-run problem. Given that the auto industry wants restrictions, the question arises to what extent the industry in Canada (which is mainly part of an integrated North American industry) is taking appropriate actions to compete with foreign producers. This research examines the marketing and investment strategies of the North American companies with this question in mind. The conclusion reached here is that the current strategy of the industry does not constitute a maximum effort to compete with foreign (mainly, small) autos. Since import restrictions would constitute a cost to the consumer and an equivalent benefit to the auto industry, this shift of resources is not now in the national interest.

The current investment strategy of the North American industry is twofold: downsizing domestic products and investing overseas. Downsizing is a process of making large cars somewhat smaller and more fuel efficient, and was initially a response to the U.S. fuel-efficiency legislation passed in the mid-1970's. Although market conditions in Canada and the United States now make mandated fuel-efficiency standards obsolete, the North American producers are still pursuing the downsizing program. The result is that Detroit and its Canadian affiliates are committed to only incremental changes from a policy of selling large cars in North America, while at the same time they are seeking controls to reduce the number of small foreign cars on the market.

The second element of strategy is overseas investment. Data on auto investments are normally confidential, and hard to compile. However, data compiled from company report and public sources indicate the North American companies have invested about 25% of total capital expenditure overseas since 1976, and that these overseas investments will increase up to 33% in some cases in the 1980's. The North American auto companies produce small fuel-efficient cars overseas that compete very well with foreign products. Furthermore, these companies are in the forefront of automotive technology in their overseas operations, as evidenced by Ford's production of alcohol-powered cars in Brazil since 1979. However, they seem unwilling or unable to apply these techniques to their North American production.

II BACKGROUND

1. Policy issues. The North American auto industry is currently suffering its worst downturn in recent history. The downturn has been accompanied by a surge of imported automobiles, mainly from Japan, which has led the automobile manufacturers and the UAW to seek import restrictions in both Canada and the United States. Briefly, the cause of the downturn has been generally held to be the collapse of demand for North American products (mainly, large cars), which in turn has been due mainly to the effects of economic recession and to rising gasoline prices after the Iranian revolution of 1979. The market collapse has been less severe in Canada than in the United States because gasoline price increases have been more gradual, but this discrepancy is now fading. Many observers have held that the increase of Japanese imports has been more an effect than a cause of the industry's downturn. Applying this reasoning, the International Trade Commission of the United States Government was unwilling in its decision of November 1980 to call for import controls on foreign automobiles. This decision followed a lengthy formal investigation which had been initiated by the United Auto Workers of America Union and the Ford Motor Company.

The United States Government under President Jimmy Carter opposed import control in 1980. However, since taking office the Administration of President Ronald Reagan has come under increasing pressure to do something on autos. In a move which unified the auto industry, General Motors finally joined Ford, Chrysler and the UAW in calling for action to reduce Japanese imports. Legislation was introduced in Congress in February 1981 to put quotas on Japanese cars to 1.6 million per annum for three years. This figure itself was an increase over the 1.2 million quota being urged by the industry. The Reagan Administration opposed mandated quotas, but the President let it be known he would find it difficult politically to veto any Congressional initiatives. As a compromise, the United States Government informally requested the Government of Japan to take the initiative in limiting auto exports to the United States.

On May 1, 1981, after consultations with the United States Government, the Japanese Government agreed to require their automakers to cut exports in 1981 by 7.7 percent. This will mean a ceiling on exports to the United States of 1.68 million vehicles in 1981, down from 1.82 million shipped in 1980, which is a reduction of approximately 140,000 units. The Japanese plan will extend for two years beyond 1981, but future export levels will be based in part on the amount of growth that occurs in the U.S. market. The Japanese auto companies denounced the agreement, but some industry spokesmen indicated they would have little alternative but to cooperate with the plan.

In market terms the cutback to 140,000 is not significant in the United States. However the figure is 70 percent of the total 1980 sales (199,595) of Japanese cars in Canada, and it constitutes about 14 percent of the entire Canadian auto market. Japanese sales in January and February, 1981 were 20 percent of the Canadian market (up from 15 percent a year ago). Based on these circumstances, the threat of a diversion of Japanese automobiles from the United States to the Canadian market, in response to the U.S.-Japanese restraint, was an important argument used to justify the Canadian restraint. This threat of diversion argument is not entirely convincing. The losses suffered by the Japanese in the U.S. market (as a result of the U.S.-Japanese restraint) could be offset by increased shipments to Canada only through very significant price reductions. It remains to be shown that such action would have been the most profitable alternative available to Japanese producers and that such would not have been subject to countervailing Canadian anti-dumping measures.

The U.S.-Japanese restraint action made no reference to Canada. Furthermore, Japan indicated initially that it would not restrain exports to Canada, since (i) Canada (unlike the United States or the EEC) has a trade surplus with Japan and (ii) Canada imposes relatively high customs tariffs on auto imports. Then on June 5, 1981, Canadian news sources announced that Japan had agreed to reduce its auto exports to Canada by six percent in the year ending March 31, 1982. This will likely postpone any restrictive action the Canadian Government might itself have considered taking. This is fortunate, since it is likely that any Canadian actions to restrict Japanese auto imports would have caused the Japanese Government to retaliate against Canadian exports to Japan.

However, the restraints against Japanese automobile exports constitute violations of the trade agreement relations between these nations which are embodied in the General Agreement on Tariffs and Trade (GATT). As such they represent threats to the international trading system protected under the GATT. The weakening of the GATT system may have particularly serious consequences for small countries highly dependent on trade such as Canada. Japan represents a large potential market for Canada and, as noted above, Canada currently has a favorable balance of trade with Japan. In view of the restrictions on its automobile exports, how can Japan reasonably be expected to respond to requests from other nations at future multilateral trade negotiations for improved access to the Japanese market?

The automobile industry mounted as much pressure in Canada as it did in the United States in favour of import controls. It is unlikely that this pressure will be deflected very long by the Japanese restraint action, especially since this

action is not expected to make a large impact on the overall North American market in automobiles. Should the issue of import controls arise again, the Canadian Government should seek to assess whether the auto industry in Canada is itself taking appropriate actions to compete with Japanese imports. The purpose of this paper is to provide data on this question.

The nature of the Canadian automobile and auto parts industry creates constraints for the Canadian Government. As a result of the Canada-United States Automotive Agreement of 1965 (Auto Pact), the Canadian auto industry is completely integrated with the U.S. industry, a fact that is often not full appreciated in Canada.[1] Furthermore, the Canadian industry consists mainly of affiliates of the major U.S. automakers, which means that the marketing and investment decisions of the industry are usually taken outside of Canada. As a result of this integration, any analysis of the Canadian industry must necessarily include an analysis of the auto industry in the United States. It further follows that any conclusions drawn from a study of the performance of the auto industry would likely be as pertinent for the United States Government as for the Government of Canada.

There is, however, a unique characteristic of the Canadian segment of the North American automobile industry which bears importantly on the subject at hand. A disproportionately high proportion of Canadian production is large-sized automobiles and light trucks. If Canadian consumers respond to reduced availability of Japanese automobiles primarily by purchasing the smaller sized North American produced automobiles then, the United States segment, not the Canadian segment, of the North American industry will reap the main benefits from the Canadian-Japanese restraint.

2. History of the industry. The North American automobile industry is composed of four domestic manufacturers, namely: General Motors, Ford, Chrysler, and American Motors. The first three produce a full line of automobiles, and in 1979 held approximately 45%, 20% and 10% respectively of the domestic automobile market. A fifth manufacturer, Volkswagen, assembles autos in the United States, which are considered domestic production in that country.

The auto was an European invention, but it was North American techniques of mass production that first made it available to the consumer. Mass production gave the United States and Canada an early dominance in international trade. In the early 1900s French production exceeded North American production, but by 1913 output in North America was ten times that of France. By 1929, United States companies were exporting over 400,000 autos per year, while American imports were fewer than 1,000.[2] In the same year, taking advantage of British Empire preference, Canada itself exported 102,000 vehicles, or 39 percent out of a total production of 265,000.[3]

The Canadian auto industry has been tied to the American industry since its inception. The high tariffs of the National Policy of 1879 encouraged U.S. manufacturers to establish affiliates in Canada. Conversely, Canadian firms found it profitable to join the American companies. For example, the Canadian-initiated McLaughlin Motor Car Co. was established in 1908, but in 1915 it established the Chevrolet Motor Co. under contract with the American firm, and it merged in 1918 to form the General Motors Co. of Canada. The Auto Pact of 1965 created a legal integration between the Canadian and American industries which in economic terms had always existed in fact.[4] What the Auto Pact did insure was that production would be rationalized for a larger North American market, which was especially important for the Canadian industry. For example, prior to 1965 there were no exports of vehicles from Canada to the United States. By 1977, 67 percent of all vehicles assembled in Canada were sent to the United States, and currently this figure is closer to 75 to 80 percent.[5] Conversely, United States imports constituted 6.5 percent of the vehicles sold in Canada in 1964; by 1977, this figure had risen to 67 percent.

As part of their export strategy, American firms established subsidiaries abroad in the early days of the automotive industry. For example, Ford set up an assembly plant in the United Kingdom in 1911, in France in 1913, and in Germany in 1926. These actions affected the mix of exports, driving down the numbers of new cars exported and increasing the export of parts for assembly in Europe. In 1915, new cars accounted for 87% of automotive exports, and in 1930 this figure had fallen to 58%. Further depressing North American exports of both new cars and parts was the trend of domestic manufacturers toward the production of large cars, which were unpopular with foreign consumers. North American automotive exports fell sharply after 1930, and continued to decline until by 1960 American and Canadian firms did not have significant exports other than to each others markets.

While the North American companies were losing their early export advantage, they were nevertheless able to maintain a completely ascendant position in domestic markets. There were very few foreign cars sold in North America before 1948, and imports did not reach significant numbers until the mid to late 1950s. By 1965 import penetration in the United States was still only 6%, but it grew steadily after that. The response of the domestic auto manufacturers to import competition has been to differentiate as much as possible the North American automobile from those produced elsewhere in the world, and to concede the bottom end of the market (i.e., small cars) to foreign producers. The strategy of differentiating involved investment in larger and more powerful cars, and investment in the advertisements needed to convince the public in Canada and the United States that North

American roads required more substantial and faster cars than foreigners were able to produce.[6] It should be noted that this strategy worked best when the only high-volume, low-cost exports foreign firms were capable of producing very small cars such as the VW Beetle. As foreigners (particularly Europeans) became more affluent and demanded larger autos, their auto firms responded by mass-producting mid-sized cars that were also popular in the United States. This stimulated domestic manufacturers to introduce compact, and later, subcompact, vehicles to the North American market (e.g., Vega, Pinto, Chevette) but these models did not establish a strong sales position, particularly in comparison with Japanese competition. In retrospect, it is doubtful whether American firms ever made a serious effort to capture the mid-sized market in United States. Such a move would have inevitably reduced sales of large cars and would have called into question the basic strategy of differentiating the domestic market.[7]

III ANALYSIS

The production and marketing strategy of the North American automaker has undergone a substantial change as a result of the energy revolution of the 1970s, although the change is not as significant as portrayed by the auto companies themselves. Prior to the early 1970s, the industry pursued a twopronged strategy: internally, it sought to differentiate its product from the interntional market; while externally, it sought to profit from higher growth rates in foreign markets through overseas investment. By 1980, after some uncertainty, differentiation had given way to a strategy of downsizing the domestic automobile. However, overseas investment continued unchanged. Both downsizing and overseas investment have potentially adverse implications for the competitive position of domestic auto manufacturers in the North American market.

1. Downsizing. A shift in marketing occurred in the American auto industry in the mid-1970s, which has been described by Ford Chairman Philip Caldwell as "the most massive and profound industrial revolution in peacetime history".[8] What this shift consisted of was a decision to downsize the American automobile, which was made initially by GM and later by Chrysler and Ford. Downsizing has been defined by the United States Department of Transportation as follows:

> "In downsizing, the manufacturers take advantage of their regular model changeover to redesign their cars with a shorter wheelbase to reduce weight without dramatic changes in design concept. Interior room is preserved for the most part, and fuel economy is improved through weight reduction and some aerodynamic refinements. Downsizing typically requires design changes primarily to the body of the car, with relatively minor changes to the basic powertrain, steering and suspension systems."[9]

GM originally used the term downsizing to its first compact luxury car, the Cadillac Seville. Downsizing at GM also referred to decisions taken by the company to introduce new products to improve average fleet fuel economy, specifically decisions to commence production of the Brazilian-made sub-compact Chevette in the United States, and to initiate a new line of front-wheel- drive (fwd) compacts (X-bodies, e.g., Citation) to be ready for 1979. Exactly how this downsizing action was taken at GM has been the subject of some fascinating analysis by Joseph Kraft.[10]. Kraft indicates that on the one

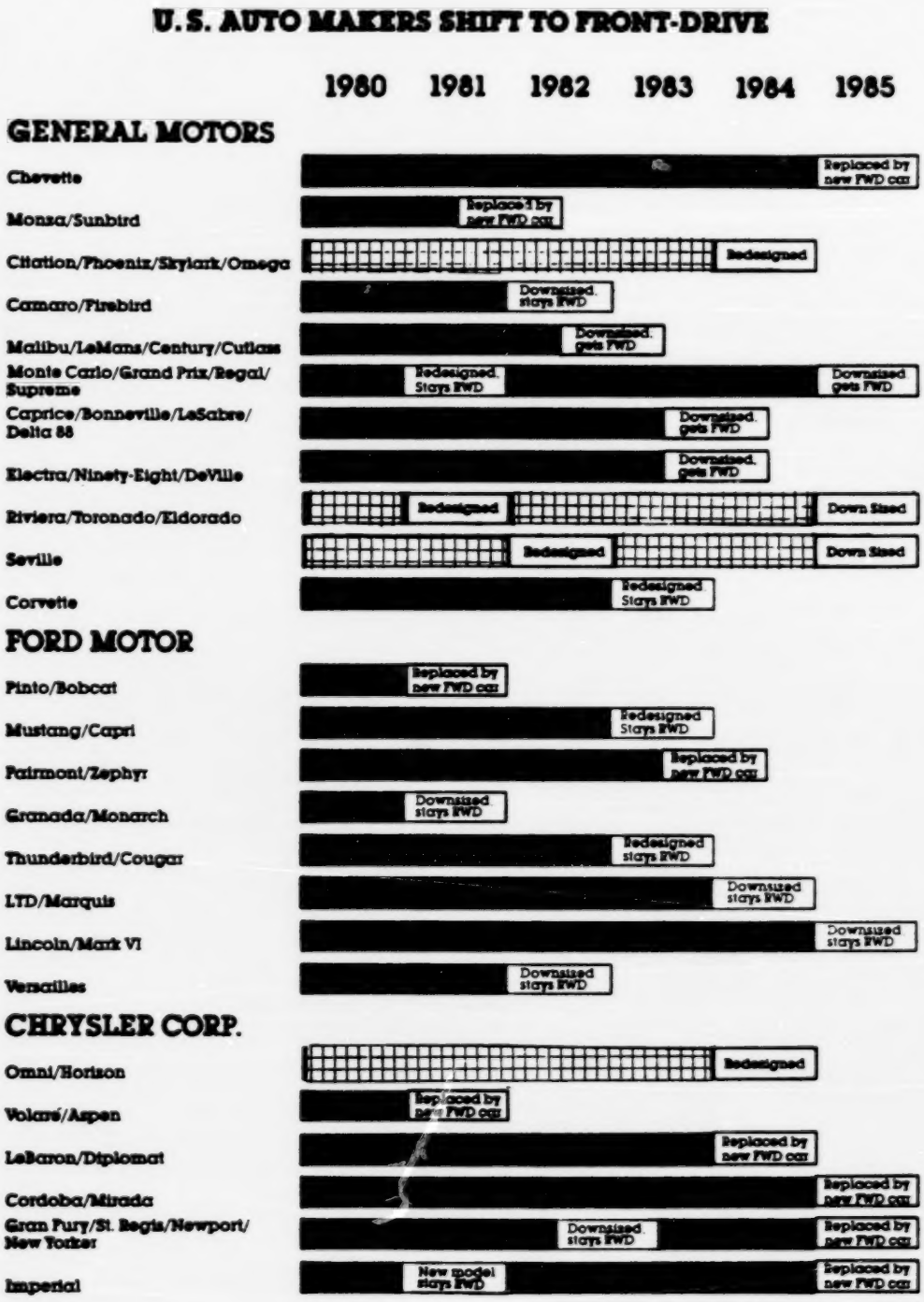
one hand company spokesmen were inconsistent in their explanations about the timing and reasons for the decisions, while on the other hand government officials and observers of the industry have suggested that the decisions were made principally in response to government-mandated standards, particularly the fuel-efficiency requirements initiated in U.S. Government's Energy Policy and Conservation Act of 1975. Whatever the reasons for the decision, it is certainly the case that the Act's corporate average fuel efficiency (CAFE) requirements, which require passenger cars to have an average 27.5 MPG fuel consumption by 1985, were entirely consistent with GM's decision; and vice-versa. What is further consistent with the decision is the market developments of 1979-80, for consumer demand for small cars has now made the U.S Government standards on fuel efficiency irrelevant.

The downsizing plans of the North American firms are shown in Figure 1, and are based on estimates compiled from public sources by Automotive News, and published in Auto Situation: 1980 (footnote 8). These data show that in general GM and Ford (Chrysler is an exception) are downsizing their larger autos, but that the only cars they are replacing or redesigning are their smaller models. For example, GM's X-body (e.g., Chevrolet Citation) replaced the compact Nova, Ford's Escort/Lynx will replace the Pinto/Bobcat, and Chrysler's K-bodies will replace the Volare/Aspen. Further plans are for GM's compact-sized J-cars (e.g., Chevrolet Cavalier) to be introduced in 1981 simultaneous with the retirement of Monza/Sunbird,[11] and for a new sub-compact S-car to replace the rear-drive T-car (Chevette) in 1984. The result of these downsizing plans is that the North American manufacturers are moving more slowly to smaller cars than current advertisements might suggest. As the Ways and Means Sub-Committee comments:

> ". . . many of the new models do not replace big car production as much as they replace existing lines of fast-selling small cars. The result is a slower shift toward increased fuel efficiency and small car production than many may have assumed (italics in original)."[12]

The downsizing plans of the North American industry represent essentially an incremental and gradualist movement away from a practice of producing large cars. The aforementioned U.S. Department of Transportation report, which is essentially sympathetic to the industry, has admitted as much in the following terms: "For many reasons, the U.S. automotive industry has been preparing for future production requirements in an evolutionary way."[13] The problem is that the reality of international competition in the industry is changing faster than the North American auto companies, and evolutionary change like the downsizing strategy may not be sufficient to keep the industry competitive with foreign producers.

FIGURE 1*



NOTE.—Graph lines indicate redesigned models, while solid lines indicate either no change downsizing only (see appendix B).

Source : Automotive News, January 7, 1980.

* Taken from Auto Situation: 1980, page 22.

There are two major difficulties with the downsizing strategy: high costs and low market acceptability. On the first point, the downsizing program has been exceptionally costly for the Big Three automakers. In testimony before the Senate Sub-committee on Economic stabilization, Ford spokesmen claimed that it cost $1 billion to raise its corporate average fuel economy by one mile per gallon, while GM spokesmen stated that the investment needed to meet mandated fuel economy standards would take about $10 billion of the $21 billion investment projected fro North America for the period 1979-81.[14] Furthermore, it should be noted that most of the easy mileage improvements through downsizing have already been accomplished, and that companies predict future improvements in fuel efficiency will cost about $2.5 billion per half mile gained. Of course, it is possible that the downsizing costs may have been overstated by the auto companies in an effort to get the U.S. Government to relax its fuel economy requirements. On this point, it is noteworthy that expensive model changes have been regularly and voluntarily undertaken by these firms. Now that fuel economy is dictated by the market rather than government the costs associated with downsizing will not appear as prominent. Nevertheless, there is no doubt that the cost of downsizing large cars has been high, and that it has pre-empted to an important extent the investment dollars that the domestic industry spends in North America. As Ford states about its worldwide 1978 capita expenditures: "About three-fourths of the 1978 spending was in North America, primarily to comply with government-mandated standards."[15] It is regrettable that this large effort was unable to achieve no more that "evolutionary" change.

On the second point, regarding market acceptability, it would appear that downsizing may have been dubious proposition from the very outset. For example, a 1978 study conducted by the Automotive Division of Chase Manhattan Bank claimed that an attempt to force consumers to buy downsized vehicles (i.e., mix-forcing) would meet with consumer resistance and prove disastrous. The report states:

> "Moreover as shown in this report, there is a great deal of additional market research and econometric evidence to indicate that consumer resistance to the large-scale mix-forcing required to meet the current standards would be massive - leading to significantly lower domestic auto sales and concomitantly higher imported car sales."[16]

Of course the conclusion of the Chase study was that the government fuel economy requirements should be relaxed, a position which the auto industry itself has consistently maintained since 1975. The requirements were not relaxed and the downsizing program continued. Whether it might have worked under any reasonable set of assumptions is conjectural, but it proved

to be a wholly inadequate strategy to meet the increasing gasoline prices that occurred after 1979. As Harry A. Stark, editor of Ward's Automotive Yearbook, summed it up:

> "To GM, Ford and Chrysler, which had poured many, many millions of dollars into larger-car economy improvements for '80, the late-1979 sales trends towards smaller models were a crushing financial blow. Ford's exclusive AOD or automatic overdrive transmission for its larger cars was one example."[17]

A second aspect of Detroit's downsizing strategy has been the development of new, smaller fuel-efficient autos. It is well known that Detroit has been reluctant to develop small autos. This is because large cars, which can be more easily "loaded" with expensive accessories such as automatic transmissions or air conditioners, are much more profitable than small cars, a point which has been made by Representative Charles Vanik, former Chairman of the Ways and Means Trade Sub-Committee:

> "I do not want to hear any auto representatives say that Detroit built big autos because that is what the American people want. Sure, the people want big cars, because Detroit spent billions on Madison Avenue to convince the American people they wanted big cars. Detroit wanted big cars because big cars meant big bucks."[18]

Despite its reluctance to produce small cars, however, Detroit found it necessary to respond to government fuel efficiency requirements and changing market demand. The auto manufacturers have now developed a number of new smaller models for the North American market, but there are questions as to how well this aspect of Detroit strategy will enable it to compete with foreign producers.

Detroit's plan for the development of fuel-efficient autos have been estimated by the Ways and Means Trade Sub-Committee and are presented in Table 1. These plans show there is considerable growth of production of smaller cars, but the growth is mainly in the compact cars (e.g., X-body, K-body, and J-body) and not in the sub-compact category, which includes the models Chevette, Escort/Lynx, Omni/Horizon and Rabbit. This figure is only 16.6 percent of total projected productions of 11.1 million. The problem, however, is that it is in the sub-compact category that imported cars have made the greatest inroads in the North American market. For example, the most popular Japanese cars in the United States now are the Datsun 210, the Honda Accord, and the Toyota Corolla.[19] It would seem that the North American producers are not planning to fully meet competition in the sub-compact category.

TABLE 1

ESTIMATED U.S. NEWLY-DESIGNED FUEL-EFFICIENT CAPACITY, 1980-85

[In thousands]

1980:	
General Motors:	
Chevette	400
X-body	800
Total	1,200
Chrysler: Omni/Horizon	300
Volkswagen: Rabbit	250
Total, 1980	1,750
1981:	
General Motors:	
Chevette	400
X-body	860
J-body	450
Total	1,710
Ford: Escort/Lynx	485
Chrysler:	
Omni/Horizon	300
K-body	525
Total	825
Volkswagen: Rabbit	250
Total, 1981	3,270
1982:	
General Motors:	
Chevette	400
X-body	860
J-body	500
A-body	400
Total	2,160
Ford: Escort/Lynx	600
Chrysler:	
Omni/Horizon	300
K-body	700
Total	1,000
Volkswagen: Rabbit	250
Total, 1982	4,010
1983:	
General Motors:	
Chevette	400
X-body	860
J-body	500
Intermediate/standard	2,500
Total	4,260
Ford:	
Escort/Lynx	600
Compact/intermediate	700
Total	1,300
Chrysler:	
Omni/Horizon	300
K-body	900
Total	1,200
Volkswagen: Rabbit	450
Total, 1983	7,210
1984:	
General Motors:	
Chevette	400
X-body	860
J-body	900
Intermediate/standard	3,000
Total	5,160
Ford:	
Escort/Lynx	700
Compact/intermediate	1,300
Standard	1,300
Total	3,300
Chrysler:	
Omni/Horizon	300
K-body	900
Total	1,200
Volkswagen Rabbit	450
Total, 1984	10,110
1985:	
General Motors:	
Chevette	400
X-body	860
J-body	900
Intermediate/standard	4,000
Total	6,160
Ford:	
Excort/Lynx	700
Compact/intermediate	1,300
Standard	1,300
Total	3,300
Chrysler:	
Omni/Horizon	300
K-body	900
Total	1,200
Volkswagen: Rabbit	450
Total, 1985	11,110

Note: All data based upon estimates made by U.S. Department of Transportation and public information available through trade magazines.

There is a considerable difference in weight, fuel-efficiency, and price between the compact and sub-compact autos. For example, the Consumer Reports issue of April 1981 on the 1981 cars lists the characteristics of the Chevrolet Citation 4 as follows: weight, 2640 lbs.; mileage, 18.2 in city and 30.4 on expressway; and price, U.S. $6,270. By comparison, the Toyota Corolla 4 is: weight, 2,000 lbs.; mileage, 20.8 in city and 36.6 on highway; and price $4,978. The Datsun 210 is $500 cheaper than the Corolla and gets about 5 MPG better, while the Honda Accord is considerably more expensive (about $7000), but gets mileage consistent with the Toyota Corolla. It would seem that the main reason why the Corolla and Datsun 210 are popular with North American consumers is that they are inexpensive high-mileage cars.

The auto market in North America is moving toward small cars. This statement is an obvious truism for the period since 1979, but what is less obvious is that the trend toward small cars has been occurring for some time, even though the auto industry usually claims the shift has been sudden and dramatic. The comparative sales of large and small cars in the United States in the 1970s are presented in Table 2.

Table 2

Market-Class Comparisons for United States and Imported Automobile, 1970-80[1]

	U.S. small[2]	Imports[3]	Total small	U.S. large[4]
1970	21.57	15.26	36.83	63.17
1971	23.21	15.22	38.43	61.57
1972	23.51	14.76	38.27	61.73
1973	28.31	15.83	44.14	55.86
1974	33.32	15.85	49.17	50.83
1975	35.18	18.29	53.47	46.53
1976	33.12	14.78	47.90	52.10
1977	29.68	18.55	49.23	51.77
1978	31.67	17.69	49.36	50.64
1979	33.75	21.85	55.60	44.40
1980[5]	37.49	26.40	63.89	36.11

Explanatory Footnotes for Table 2:

1 Taken from Auto Situation: 1980, 13. Original data compiled from Automotive News and Ward's Automotive

2 Subcompact and compact.

3 Small.

4 Intermediate and luxury.

5 1st 3 months of 1980

As the data in Table 2 demonstrates, in 1970 Americans bought large cars over small cars by a ratio of 63/37 percent. By 1980, these figures had almost exactly reversed in favour of small cars. More significant is the trend revealed in the table. In eight out of the ten time periods represented between 1970 and 1980, demand was falling for large cars and increasing for small cars. The auto industry has made much of the fact that the market shifted back to large cars two to three years after the oil crisis of 1973, but the data would suggest that the recovery of large-car sales after 1975 is not a complete as the industry had claimed. What the Table does not show is that sub-compacts have been the fastest growing portion of small car sales, and it is in this area that the North American manufacturers have not made a maximum effort.

Recent press reports indicate there may be some backing off by the North American automakers on the commitments they now have to produce small cars. For example, Ford has complained that although the sub-compact Escort/Lynx has been selling "splendidly" in North America, the company has been unable to make profits on the auto. This is puzzling, since Ford has become one of the leading auto companies in Europe mainly by selling cars like the Escort. Ford indicates that its marketing emphasis in North America will likely be on larger cars than the Escort. For example, according to Will Caldwall, executive vice president and chief financial officer at Ford:

> "The theoretically more profitable Granada/Cougar are getting special marketing attention . . . They represent our big cars of the future . . ."[20]

This policy means that Ford will be emphasizing a product that weighs slightly over 3000 lbs., cost $6474, and gets 13.9 MPG in the city and 24.0 MPG on the expressway; at the expense of a product that weighs 1000 lbs. less, cost only $5158, and gets 20.0 MPG in the city and 40.00 MPG on the expressway. Ford's policy clearly will not serve consumers who are seeking to purchase small, inexpensive, fuel-efficient autos.

A similar process may also be occurring at General Motors. GM chairman, Roger B. Smith, has been recently quoted as saying "people don't want small cars - what they want is fuel-efficient cars", and there have been reports that GM is backing off plans to speed the development of sub-compacts and other fuel-efficient products, such as the electric auto. As a case in point, a New York Times article notes that GM is delaying development of four and three cylinder engines, and is re-evaluating the S-car sub-compact, due for production in 1984.[21] These delays became known when GM notified its component suppliers to delay orders, an action which subsequently was reported in Metalworking News. Commenting on the GM action, industry analyst Maryann Keller suggested GM may have decided it could not produce a sub-compact profitably in North America.

Nevertheless, GM recently joined Ford, Chrysler, and the UAW in lobbying for import controls on Japanese autos, which are mainly in the sub-compact category. The manufacturers apparently do not want competition in the sub-compact category, even though they are not making a full scale effort in this area.

2. Overseas investment. The North American auto industry is rapidly becoming a global industry in addition to simply being a multinational operation. Individual companies not only pursue an international marketing strategy and maintain foreign branch plants, which makes them multinational; but they also have established integrated facilities in different countries on the production side, which makes them global. The major auto companies are now moving toward the concept of a "world car", which means a car assembled from components manufactured in several different countries, and marketed in several countries as well. The move toward global concerns is an expression of conscious corporate philosophy in some companies, as evidenced by the opening lines of Ford's Statement of Corporate Purpose: "Ford Motor Company is in business to meet automotive, agricultural, financial services and communications needs of the worldwide society (my emphasis) and, in the process, to create profits for its stockholders".[22] This global orientation creates some difficulties in the relations between auto companies and governments, since the latter by definition have a national not global perspective. It is on the matter of protecting consumer interests and the rights of labour, which are particularly national concerns, that relations become most difficult.

Analyzing the overseas investment practices of modern multinational companies creates a major problem for economic analysis. In a competitive, marketplace economy investments decisions are, in theory, wholly left to the purview of individual companies. With the exceptions of laws designed to protect the public (e.g., anti-trust), the practice largely conforms to the theory, particularly in North America. Companies, for reasons of competition, do not divulge investment data, except in very general or aggregative statements, and they certainly do not reveal their investment strategies for the future, with only exception being fragmentary pieces of information that are useful for a company to release. As a result, it is difficult to piece together a complete picture of what the auto industry is doing now, or what direction it will head in the future. One must work from anecdotal sources (largely from newspapers) that cannot easily be cross-checked with other information. If there is any consolation, it is clear that even government officials responsible for national policy in the transportation and trade areas are in largely the same position as the independent researcher.[23]

As indicated earlier, the overseas operations of the North American auto manufacturers have long been a part of their overall industrial strategy. In the early period, the U.S. companies assembled American-designed models abroad, but this procedure diminished as the North American market became increasingly differentiated from those abroad. As foreign producers, particularly in Europe, developed a capacity to produce for their own markets, American firms operating there were forced to develop "European" cars to meet the competition. As a result, American companies overseas now have the capacity to produce small fuel-efficient autos (e.g., Ford's Fiesta) which they have not produced in the United States or Canada. Moreover, American companies have met with enormous success, again particularly in Europe, in their efforts to produce and sell cars abroad. Ford, behind VW and Renault, is now the third largest producer of automobiles in Europe. Together, Ford and GM held by 1979 approximately 20.5% of the total European market. the competitive position of these American-based companies is strong, and it is expected their position will improve vis-à-vis weaker European companies in the future.[24]

The current strong position by Ford and GM overseas stems from a perception derived during the mid-1960s that more rapid growth in auto sales would be realized abroad than in North America. The companies invested heavily in overseas markets, diversifying their operations between different countries in order to achieve economies of scale. In recent years, this investment has been a significant portion of overall expenditures on new plant, tooling and equipment. For the past few years, Ford has averaged approximately one-fourth of its capital expenditures abroad (see Tables 3 and 4). GM has averaged less (see Tables 5 and 6), but the company is now commencing a massive investment program in Europe. This program will entail allotting 25% of all capital expenditure to overseas operations for 1980, 1981 and 1982, with half of that going to Europe.[25] GM President E.M. Estes has claimed that this program will give GM the capacity to top Ford in overseas markets by 1983.

As part of its overseas program, GM announced in June, 1980, plans to invest $2 billion in a new plant in Austria and two new facilities in Spain.[26] In both cases incentive programs were given to GM by the respective governments. The Austrian plant will build new 1.2 and 1.4 litre engines and employ 1,500 workers, while the facilities in Spain will involve both manufacturing and assembly, and employ a total of 10,500. There are no plans to export the Spanish-produced cars to the United States. GM also recently took over Chrysler assembly plants in Venezuela and its intends to increase the assembly capacity of its Mexican operations and to build a new engine facility there.[27] The company previously announced plans to build a new plant near Melbourne, Austrilia, to manufacture four-cylinder engines.

Table 3

Capital Expenditures of Ford Motor Company[1]
(in $ millions)

	1976[2]	1977	1978	1979
United States	317	1,280	1,884	2,347
Canada	34	120	160	182
Europe	160	239	327	728
Latin America (including Mexico)	33	78	85	163
Other	7	45	86	80
Total	551	1,762	2,542	3,440

Explanatory Footnotes for Table 3:

1 Includes expenditures for facilities, machinery and equipment, and tooling. Data for 1977-79 taken from Ford Annual Report, 1979; data for 1976 taken from Ford Annual Report, 1978

2 Data on capital expenditures are not consistent over time in Ford Annual Reports. For example, the 1979 Report lists total 1978 expenditures as $2,542 m., while the 1978 Report lists total expenditures for the same year as $1,572 m. It is probable the figures for 1976 are understated, since they are taken from the 1978 Report.

Table 4

Capital Expenditures of Ford Motor Company[1]
By Percent By Region

	1976	1977	1978	1979
United States	57.5%	72.6%	74.1%	68.2%
Canada	6.2%	6.8%	6.3%	5.3%
Overseas	36.3%	20.6%	19.6%	26.5%
Total	100%	100%	100%	100%

Explanatory Footnote for Table 4:

1 Data derived directly from Table 3

Table 5

Total Capital Expenditures of General Motors Company[1]
(in $ millions)

1975	1976	1977	1978	1979
1,201	999	1,871	2,737	3,372

Explanatory Footnote for Table 5:

1 Includes expenditures for new plant, tooling and equipment. Data compiled from verbal statements in General Motors Annual Reports, 1975-79. Regional breakdowns of actual expenditures not available.

Table 6

Capital Expenditures of General Motors Company[1]
By Percent By Region

	1975	1976	1977	1977	1979
United States	81%	80%	87%	86%	74%
Canada	4%	4%	6%	3%	4%
Overseas	15%	16%	7%	11%	22%
Total	100%	100%	100%	100%	100%

Explanatory Footnote for Table 6:

1 Includes expenditures for new plant, tooling and equipment. Above data compiled from verbal statements in General Motors Annual Reports, 1975-1979.

The move by GM into Spain was made shortly after the Spanish government refused to meet the demands of Ford for even greater incentives. For GM, Ford represents its major overseas competitor. Ford operates on every continent and in numerous countries and territories. More importantly, the company's foreign operations have recently been its most profitable. In 1979, 44% of Ford's worldwide revenue was earned outside the United States compared to 35% in 1978.[28] Net income from overseas operations in 1979 was $1,368 million, out of a total of $1,169 (there was a $199 million loss in North American opertions). This was a $780 million increase over the previous year. By comparison, GM's overseas operations accounted for only 13% of its net earnings in 1979. Ford attributes this rise abroad to "higher volume, higher interest income and manufacturing cost efficiencies in Latin America and Europe".[29] In 1979, operations in these two regions accounted for 99% of total net income, and, along with the introduction of the Fiesta, helped push Fords after-tax return on investments overseas to 6.4%, or twice the return in the U.S.[30]

It is not surprising, therefore, that in its annual report to shareholders, Ford stated that its "confidence in Europe's future was confirmed with capital investment of more than $725 million in new plant and equipment" in 1979.[31] This represents a more than doubling of capital expenditure in Europe from the previous year and an over 200% increase over 1977. In comparison, the increase in expenditure in the U.S. was only 23% over 1978 and 90% over the 1977 figure. Ford affiliates in Europe plan to spend more than $5 billion in the next four years. "A large proportion of these expenditures", the company notes, "is earmarked for the development of more fuel-efficient engines and transmissions".[32] This includes a new four-cylinder engine plant in Wales. there is also to be a new plastics components facility in West Berlin. In addition, nearly one billion dollars will be invested in Latin America, particularly in Brazil, where in 1979 Ford began producing autos that operate on 100% alcohol. By 1985, the company expects to have the capability of supplying alcohol-powered engines for about 70% of the cars it produces.

The investment overseas on the part of GM and Ford must be placed in proper perspective. The bulk of all American automotive investment is planned for the domestic industry. For example, GM has already spent $2.7 billion in the last four years developing its "X-body" car in the United States,[33] and, by calculation, it probably spent about $5.25 billion (i.e., 75 percent of $7 billion in North America in 1980.[34] For Ford, the percentage on North American investment is much less. Ford has indicated it will spend $4 billion per year worldwide in 1981-85,[35] and that it will spend $8 billion total outside North America during 1979-84.[36] Assuming total investment on plant and equipment for the 1979 - 81 period was $4 billion per year (or $24 billion over 1979-84 period, which is probably and exaggerated figure), then the percentage of foreign investment over this same period is 33 percent, which leaves 66 percent of total investment for North America. As already noted, most of the new investment already committed and projected for the future in North America has been in downsizing domestic models.

Foreign investment is a problem for national governments because it exports jobs, and of course it is usually in order to save jobs for American or Canadian workers that Governments are asked to apply restrictions on foreign imports. Another aspect of this same problem is foreign sourcing, or the acquisition of foreign-built components for autos assembled in North America. Foreign sourcing is a sensitive issue, because an increasing proportion of labour input in automobile manufacture is in components such as engines and transmissions, and because sourcing these components in foreign countries clearly reduces the role of Canadian and American labour in the production of domestic autos. Foreign sourcing was an important concern of the Carter Administration. While only about three percent of the value of U.S.-produced autos comes from imports, this percentage is expected to rise sharply in the case of modern, fuel-efficient, small cars. A case in point is the U.S.-version of the Ford Erica, which will likely be assembled from components sourced in Mexico. The concern over foreign sourcing led the Carter Administration to press for a major information-gathering and analytical effort to assess the trend of internationalization of the automobile industry. The results of this effort can be seen in the aforementioned DOT Report (see ftn. 9), which presents information (compiled wholly from public sources) on recently announced foreign sourcing commitments by U.S. auto manufacturers. The Report indicates that commencing in 1983, Ford will purchase 400,000 small-car engines from its plant in Mexico.

It would appear there is currently an element of threat in the foreign sourcing plans of the auto companies, at least as these plans relate to proposed import controls. Both Ford and GM have stated they would likely increase foreign sourcing if imports were not reduced. For example, in a published interview

Ford President Donald E. Peterson has said that if imports were not cut,

> "I think it should be pretty apparent that there will tend to be progressively more decisions to out-source components, to out-source whole automobiles if necessary".[37]

As for GM, Automotive News has reported on testimony before Congress by Harvard Professor William Abernathy as follows:

> "Abernathy quotes a GM official to the effect that GM will remain Number One - whether it is in the U.S. or Brazil. He expects both GM and Ford to adapt and survive - if only by shifting production to lower-wage-rate, less-developed countries".[38]

It would be ill-advised for governments to react to the attempts by the auto companies to link foreign sourcing and import controls. It is unlikely that import controls would affect foreign sourcing decisions unless such controls were both severe and permanent, and that is not now being proposed even by the auto companies themselves. What is a more likely scenario is that governments might apply controls and then find that the auto companies have continued their foreign sourcing plans unabated. If this occurred, there would be a parallel with the colour television industry, where Zenith substantially moved its production facilities overseas after it waged a successful campaign to get the United States Government to negotiate an orderly marketing arrangement (OMA) with Japan that restricted Japanese imports of colour TVs.[39]

It is often assumed that industres invest overseas in order to take advantage of cheaper foreign labour. This is almost certainly not the only reason in the case of the auto industry. It is well known that many foreign countries maintain export promotion schemes (e.g. the BEFIEX agreements in Brazil) that require multinational companies, if they want to sell their products in a foreign market (which they do), to also move a portion of their production to the same market. Also many nations compete for foreign investment directly by offering investment incentives. That these incentives can become as important in investment decisions as comparative wage rates is evident in the following statement by Senator Metzenbaum of Ohio on the Ford decision to locate a new engine plant in Mexico:

> "To compound the unemployment problem in my home State, the Ford Motor Co. has recently confirmed a fact I revealed earlier this year. Although Ford originally denied my accusation, they have now announced that they will begin construction of a massive $350 million engine plant in Mexico, drawing more than 10,000 jobs from the Brook Park engine plants in Cleveland.

> Ford documents which I have uncovered have shown that the per unit cost of building an engine in Mexico as opposed to Cleveland is almost identical . . . about $1,054 per unit in Cleveland as against $1,052 in Mexico. However, the Mexican Government has offered Ford an enormous package of tax breaks, which reduces the per unit cost by approximately 46 per cent.
>
> I strongly oppose the program of exporting jobs and manufacturing capacity to Mexico. In my view, a Ford engine built in Mexico is just the same as a foreign car imported from Japan or Germany, and should be considered part of any trade agreement. I would support countervailing measures against the huge Mexican tax incentives."40

The position of the North American auto companies to investment competition has been one of ambivalence. On the one hand voiced disapproval, while on the other hand, they have encouraged governments (and communities) to compete for investment funds, a competition from which they obviously benefit. As a case in point, consider the following remarks by W.R. Waugh, Vice-President of General Motors of Canada:

> ". . . We think it is a fool's game, but we also state that it is the only game in town. Governments have got to decide whether they are going to play it or not, because there is competition in this area. Are we going to be competitive?
>
> Our company did not get into the game until Volkswagen got a plant for one dollar and a lot of substructure to go with it, and we decided we better be competitive. We just got 100 million dollars for locating an engine plant in Austria and other plant will be located in Spain for an equally substantial grant.
>
> So I don't know what we should do about that. My own mind rebels at Ottawa grants. I don't think it is an orderly process, but I worked for a number of years in three different cities in the United States where I was involved in the Chamber of Commerce kinds of activities, and I did see one philosophy that you might want to consider. There the individual communities went after industry. It wasn't left to a Queen's Park or an Ottawa to attract industry. These communities were offering tax relief. They were reducing some of the costs of new plants.

> There is another aspect to it. Have our (i.e., Canadian) communities stopped being competitive? Have they forgotten how to be competitive? Are we leaving it all the the Municipal Board or to Industry, Trade and Commerce?"[41]

The above quotations demonstrate there are now structures and incentives in the international economy to encourage production facilities within the auto industry to become very mobile. Furthermore, the industry is itself fully prepared to be mobile across international boundaries. It would be ill-advised to pursue a policy of import controls (which would hurt consumers and the national economy through price inflation and decreased fuel-efficiency) in order to save jobs in the domestic industry, when those jobs are being threatened by larger forces that could easily overwhelm the economic effects of import controls.

* * * * * * * * *

The conclusion from this analysis of marketing and investment patterns in the North American auto industry is that the domestic automakers have been putting a large proportion of their total investments into foreign countries, and that this proportion has increased in the early 1980's.[42] This investment, plus the capacity for foreign sourcing of components which foreign investment makes possible, creates a threat to domestic labour and undercuts any policy of import controls that might be undertaken to protect domestic labour. Furthermore, the overseas investments of the North American automakers are basically profitable, and they have demonstrated in their operations abroad that they are in the forefront of energy-saving technology and are fully capable of producing small, competitive, fuel-efficient vehicles. However, in their domestic investments, these same companies have pursued an incremental, and even questionable, strategy of downsizing largely in response to legislated requirements for fuel economy. It would appear in the last decade that the creative energies (in addition to capital) of American automakers have gone overseas, a conclusion that is supported by Ford's Annual Report:

> "The record level of spending (in 1979) was the result of the Company's program to introduce new products in world markets and to meet government-mandated regulations in North America."[43]

The American auto industry has had a long-standing commitment to produce large cars, a commitment that has been reinforced over the last decade by the fact that large cars, where there was little foreign competition, presented a more profitable market than small cars. What downsizing initially meant, above all, was an attempt to make the large car consistent with regulations on fuel economy, in the belief that the North American market would not demand small (i.e., sub-compact) cars. Downsizing was an attractive way to meet government regulations because it could be introduced gradually while efforts continued to remove the requirements, because early results could be achieved with relatively little cost, and finally, because it promised some continue differentiation between North American cars and those made overseas.

It is clear the downsizing program is beginning to cost the auto companies a great deal. for example, General Motors has announced plans to spend $40 billion in the 1980-84 period, mostly for the downsizing program. Recently the company has indicated it might spend a further $40 billion later in the decade, but not for another vehicle downsizing program. As stated by GM Chairman Roger B. Smith:

> "Hopefully when we get it (downsizing) done and if everything settles down in the world, our spending should drop . . .
>
> But it probably won't . . . I don't want to spend another $40 billion (in the late 80's) on another round of car downsizing. But it wouldn't bother me (to spend that money) if we're doing it on new components factories, our new electric car, new microprocessor factories, new products and all the other things I see coming down the road."44

It is regrettable that the innovations Smith sees as important were not included in the 1980-84 phase of General Motors' investment plans, since it is clear the competition GM is facing will not be standing still until the late 1980's.

IV. POLICY CONSIDERATIONS

The main policy issues faced by the Canadian Governemnt has been how to respond to the demand by the domestic auto industry for import controls on Japanese cars. This demand has been temporarily deflected by the Japanese Government's voluntary restriction of exports to Canada for one year. It is unlikely the Japanese action will produce a permanent solution to the problem, and it is likely the the Government will face the issue of import controls again in the near future. The recommendatons flowing from this research are that the Canadian government should not apply import controls on Japanese automobiles, and should not seek any extension of the Japanese restraint action. The reasons are because any restrictions on Japanese autos will reduce the bottom end of the market (i.e., sub-compacts) and will therefore force consumers into larger, higher-priced and less fuel-efficient automobiles. Restrictions on Japanese autos will create a benefit in increased profits for the domestic auto producers and a cost for consumers in price inflation and increased fuel costs. Indeed, increased profits are what the domestic industry says it needs, since it is now claiming it has inadequate retained earnings (i.e., a cash crunch) to finance the re-tooling needed to match foreign competition. However, the question is whether such a transfer of resources should be created through government action. The following points should be considered:

1. How much do import restrictions cost the consumer? Answering this question requires sophisticated economic analysis. A useful model for analogy was developed by the U.S. Council of Economic Advisers and presented by George Eads in Congressional testimony in March, 1980. Eads' model assumed U.S. imports in 1980 would be held to 1979 levels (a reduction of 250,000), and it produced the following results: (i) increased consumer expeditures on autos by $1 billion to $2 billion; (ii) increased domestic employment of no more than 20,000 workers (roughly $50,000 to $100,000 spent per job created); (iii) increased oil imports by one million barrels per year for up to 10 years. On this basis the Carter Administration decided against import controls.

In Eads' model the cost to consumer from price inflation of autos would be about $100 to $200 per auto, assuming a U.S. market of about 10 million autos per year. The precise cost to Canadian consumers of the Canadian-Japanese restraint may differ somewhat from these figures. On average, costs of this magnitude are not enormous, although since they effectively constitute a tax to support the auto industry, they are burdensome. However, the cost would be borne differentially. Consumers seeking inexpensive, fuel-efficient autos will find them less available. In their place they will more likely find

the domestic automakers producing compacts or intermediate rather than sub-compacts (e.g., Ford's Granada vs. Escort), and the price difference between an imported sub-compact like Datsun's 210 and Granada is about U.S. $2,000. Furthermore, without competition at the bottom end of the market the domestic automakers will increase prices on their compacts in order to reduce the price differential between their compact and intermediate models, in the expectation of increasing sales of larger cars on which they make more profits. The conclusion is that the consumer would suffer from auto import restrictions mainly from a reduction in the availability of sub-compact autos. From a national standpoint, import restrictions are poor policy from the perspective of protecting consumers' interests, controlling inflation, and conserving energy resources.

2. How will the auto industry use the increased revenues from import restrictions in their marketing? The North American market has traditionally been differentiated from the international auto market; North American production has been much larger and less fuel-efficient vehicles than those produced and demanded in other markets. This marketing strategy has mitigated against export of North American products and, in the face of rising fuel prices, has been responsible for the serious downturn which this industry is currently suffering. The domestic auto manufacturers are only incrementally changing this strategy through the downsizing program. Import restrictions will tend to maintain a differentiation and will act as a disincentive for a speedy shift into small-car production. It is questionable how serious an effort the domestic manufacturers are now making to re-tool into small-car production. For example, Ford has stated it is more likely in the future to produce Granadas than Escorts for the domestic market. Despite advertisements to the contrary, the domestic companies are increasingly unlikely to build (in volume) the small, inexpensive, fuel-efficient cars whose availability would be reduced through import restrictions. However, an increasing supply of such cars is important for Canada. The conclusion is that the domestic manufacturers are not likely to use their increased profits from import restriction in ways consistent with the economic interests of Canada.

3. How will the auto industry use the increased revenues from import restrictions in their investments? The major domestic auto manufacturers have indicated they intended to spend 25 to 33 percent of their capital investment funds overseas in the next four years, but this is inconsistent with a maximum effort to re-tool their production in North America to meet foreign competition. Overseas investments jeopardize the interests of Canadian labour; first, by creating an opportunity cost, since funds spent overseas are not available for investment in North America; and second, by creating direct competition for domestic labour, since components produced overseas can be

sourced for assembly of finished vehicles in North America. Overseas investment undercuts any government policy of protecting domestic employment through import controls on foreign-made autos. Furthermore, although the auto companies have indicated they would increase out-sourcing if import controls were not enacted, in fact import restrictions will increase the incentives for the domestic automakers to invest overseas. Import restrictions will give the domestic manufacturers less competition in their North American market, and will leave them freer to pursue a strategy of investment overseas where they face a critical struggle for market share against Japanese and other foreign competitiors in the fast-growing markets of the newly indsutrializing countries. The conclusion is that the domestic manufacturers will use their increased profits from import restrictions in investments that do not advantage Canadians, and that in fact may directly compete with the interests of Canadian labour.

4. Does Canada have alternatives? Because of the Canadian-U.S. Auto Pact, and the underlying industrial structure that it reflects, the Canadian Government has limited capacity to influence the North American automakers. Because of the relative sizes of the Canadian and United States segments of the integrated North American automobile industry, the United States represents major market for Canadian produced vehicles but the reverse is not true. Currently, 75 to 80 percent of Canadian produced automobiles are shipped to the United States market. Although 67 percent of the North American produced automobiles sold in Canada are produced in the United States, most of the automobiles produced in the United States are sold in the United States. Under these circumstances, the Government of Canada has limited capacity to influence the industry and is dependent on United States government policy.

There is a natural tendency for Canadian policy to follow the policy of the U.S. Government. The Canadian-Japanese restraint is an example of such Canadian policy. This policy was adopted inspite of the facts that this restraint imposes costs on Canadian consumers, does not protect Canadian employment, and may, in the long run, jeopardize Canadian export interests. It would be desirable for the Canadian Government to use the current crisis as a stimulus for rethinking the arrangements of the Auto Pact. It is one thing to be completely integrated with a large industry in another country when times are good. But when times are bad, nations and industries tend to look out for their own interests. This was clearly demonstrated when the U.S. Government recently sought a restraint agreement with Japan without making reference to Canada, even though the auto market in the United States is effectively an integrated North American market. It is also demonstrated by the fact that some automakers are again in default of their Auto Pact obligations, but there appears little the Canadian Government can do about it at this time.

The Canadian Government should take note of the fact that within a generally uncompetitive and overpaid automotive industry, there are independent parts manufacturers (e.g., Tridon) that have a capacity to compete in international markets. Where there to be a policy of restructuring the Canadian auto industry, it might sensibly proceed along the lines of supporting parts and component manufacturing in Canada, rather than the final assembly of North American models. Along with this could be a policy seeking foreign investment by foreign manufacturers, particularly the Japanese, that trade actively in the Canadian market. Such an investment is now being considered in the province of British Columbia. The conclusion is that the Canadian Government could have alternatives in making industrial policy for the automotive industry, but that such alternatives would require a wide-sweeping rethinking of present industrial structures.

FOOTNOTES

1. As stated by N.B. MacDonald: "What should be emphasized, however, is the fact that the Canadian industry must be examined as a constituent part of the North American automotive industry. Although this fact is self-evident, we overlook it by acting as if there were a separate (emphasis in original) Canadian automotive industry" (page 96). "(the Big Three) . . . establish the structure of the North American industry" (page 80). N.B. MacDonald "The Automotive Industry" in Opportunities in Canadian Transportation (Science Council of Canada) Report on an Industry Sub-Conference, Toronto, October 4-5, 1979.

2. Louis T. Wells, Jr., "The International Product Life Cycle and United States Regulation of the Automobile Industry" in Douglas H. Ginsburg and William J. Abernathy (eds.) Government, Technology and the Future of the Automobile (New York: McGraw-Hill Book Co., 1980), pages 270-292 and 274.

3. The Canadian Automotive Industry. Inquiry into the Automotive Industry by Simon Reisman, Commissioner. October, 1978, page 3.

4. Reisman states: "The fact of the matter is that the Canadian industry has been substantially locked into the American industry technologically, and in almost every other important respect, from the days of its founding. I must be acknowledged that in some areas there has been a decline in the ability of Canadian companies to function independently as an outcome of the Auto Pact, but the difference is one of degree rather than of kind." Ibid, page 128.

5. Ibid, page 79. See also Hyman Solomon and Patricia Best "Japanese export restraints won't revive U.S. auto sales" Financial Post, May 9, 1981.

6. Wells notes: "But the heaviest investment has been in attempts to isolate the United States market from the rest of the world." See Footnote 2 for complete reference.

7. The same argument applies to the marketing in the United States of captive imports (i.e., imports of U.S. subsidiaries abroad, such as Ford Fiesta). Sales of captive imports reached a peak in 1959 at about 24% of imports, and fell to 8% by 1976. It is obvious from congressional testimony that captive imports were sold in the United States in the mid to late 1970s mainly to comply with U.S. laws regarding average fuel efficiency, and not to compete with foreign companies in domestic small-car sales.

8. Auto Situation: 1980, Report of the Subcommittee on trade of the Committee on Ways and Means, u.S. House of Representatives, June 6, 1980, page 19.

9. The U.S. Automobile Industry, 1980, Report to the President from the Secretary of Transportation, January, 1981, page 22.

10. Joseph Kraft "Annals of Industry: The Downsizing Decision" The New Yorker, May, 1980 pages 134-162.

11. Al Fleming and David C. Smith "GMs J-Cars: The Full Story" Ward's Auto World, January, 1981.

12. Auto Situation: 1980, page 19. See Footnote 8 for complete reference.

13. DoT Report, page 29. See Footnote 9 for complete reference.

14. "Government Regulation of the Automobile Industry," Hearing before the Sub-Committee on Economic Stabilization of the Senate Committee on Banking, Housing and Urban Affairs, April 26, 1979, 20, page 717.

15. Ford Annual Report, page 17.

16. "Government Regulation . . .", page 245. See Footnote 14 for complete reference.

17. Ward's Automotive Yearbook, 42nd ed., 1980, page 17.

18. Opening statement of Congressman Charles A. Vanik (Ohio) at the Hearings on Automobile Situation before the Subcommittee on Ways and Means, March 7, 1980.

19. Clyde H. Farnsworth "Tokyo's Car Curbs Hailed in U.S., But Japanese Makers Are Angered" New York Times, May 1, 1981. Farnsworth cites Automotive News as his data source.

20. "Escort Shy of Profits, Ford says" Automotive News, December 15, 1981.

21. "Product Delay By G.M. Seen" New York Times, May 19, 1981.

22. Ford Annual Report, 1978, page 30.

23. For example, a confidential internal memorandum (the "options paper") submitted to President Carter in May, 1980, emphasized the U.S. automakers did not disclose investment plans to government, and that the data available to the U.S. Government were "anecdotal".

24. See John M. Geddes, "U.S. Car Makers Viewed as Threat by Europeans," New York Times, March 10, 1980. Geddes states "Over the long term, the American challenge is probably more intense than the Japanese threat. While Japanese imports can be legislated out of the European market and their attempts to set up plants discouraged, Ford and General Motors alreay have strong European bases from which to begin their drives."

25. John A. Russell, "GM investing $1.5 billion for growth overseas," Automotive News, June 25, 1980, 40. GM itself states: "An increasing proportion of GM's capital spending is for requirements outside the United States." General Motors Annual Report, 1979, page 11.

26. Margorie Sorge, "GM to challenge Ford overseas," Automotive News, June 18, 1980, page 3. GM claims this is "the largest overseas expansion ever undertaken by GM." General Motors Annual Report, 1979, page 6.

27. General Motors Annual Report, 1979, page 6.

28. Ford Annual Report, 1979.

29. Ibid, page 11.

30. Gerald R. Rosen and Jean Ross-Skinner, "The Auto Clash Goes Global," Dunn's Review, April 1978, page 50.

31. Ford Annual Report, page 8.

32. Ibid., page 9.

33. Charles G. Burck, "What's Good for the World Should be Good for G.M.", Fortune, May 7, 1979, page 125.

34. GM states: ". . . we anticipate that our (worldwide) capital expenditure requirements in current dollars could exceed $7.0 billion in 1980," 1979 Annual Report, page 10.

35. "Escort Shy . . ." See Footnote 20 for complete reference.

36. "Ford to Spend $500 million in Brazil" Automotive News, January 28, 1980.

37. John Holusha "Why Ford Seeks Import Curbs," New York Times, March 28, 1981.

38. Helen Kahn "Will U.S. Fade as Auto Producer?" Automotive News, February 9, 1981.

39. Ronald I. Meltzer "Color-TV sets and U.S.-Japanese Relations: Problems of Trade-Adjustment Policymaking," Orbis, Summer, 1979, page 435.

40. Congressional Record - Senate, June 18, 1980, page S7278.

41. Opportunities in Canadian Transportation pages 75-76. See Footnote 1 for complete reference.

42. It should be noted that much of the overseas investment (especially Ford's) is now financed from retained earnings abroad. However these funds could be used to retool in North America, as Henry Ford II himself admitted to Joseph Drfat: "The profits from abroad supply us with the funds we need for investment here," Kraft, page 147. For complete reference see Footnote 10.

43. Ford Annual Report, page 11.

44. Paul Lienert, "GM raises the ante to $80 billion," Automotive News, January 26, 1981, page 1.

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